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September 13, 2010

**AGENDA ITEM 3c**

**TO: MEMBERS OF THE AD HOC RISK MANAGEMENT COMMITTEE**

- I. SUBJECT:** Governance and Risk Management Initiative Recommendations
- II. PROGRAM:** Enterprise
- III. RECOMMENDATION:** Information
- IV. ANALYSIS:**

**Background:**

CalPERS provides value by advancing the financial and health security for all who participate in the system. Key strategic goals are to provide sustainable pension and health benefit products and services responsive to and valued by members, employers, and stakeholders.

To ensure CalPERS continues to provide this value, and in keeping with CalPERS strategic goals and business philosophy, in April 2009, CalPERS embarked upon a Governance Risk Management Initiative (the "GRMI" or the "Project"). The objective of the Project was to take a holistic view of risk, looking enterprise-wide at the existing governance and risk management structures and processes, to ensure that the organization has a systematic and disciplined approach to managing value and risk.

To ensure that the results of this Project have optimum applicability to the CalPERS situation, while reflecting best risk intelligent enterprise management practices, the initial focus of the project was on gaining an understanding and performing an assessment of the current governance and risk management structures, systems, processes, and organizational understanding of risk.

The results of this fact-finding have informed the recommendations that follow, and will help to ensure the acceptance and sustainability of the new CalPERS risk intelligent enterprise management architecture.

The recommendations that follow represent only the framework for CalPERS becoming a “risk intelligent” organization. These recommendations will require implementation over the next 12 to 24 months and possibly beyond. The framework may also need to be flexible as conditions change. Fundamental to becoming a risk intelligent organization is the embedding of risk intelligent management strategies, processes, and behaviors as core governance principles. Risk intelligent enterprise management should be an integrated part of CalPERS overall governance, management, reporting processes, policies, philosophy, and culture. Proactively addressing risk will help to reduce the opportunity for the occurrence of potential fraud and abuse in the administration of CalPERS programs.

Thus, the implementation strategies are organized into the following areas of focus:

1. **Strategy** – the key actions or design elements needed to achieve the goal of a risk intelligent organization. (Policy, Organization, Roles, and Responsibilities)
2. **Process** – series of steps or sequence of actions and support mechanisms, such as technology, for implementing Risk Intelligent Enterprise Management (RIEM)
3. **Behavior** – the culture and shifts in mindset necessary to sustain RIEM and the risk intelligent organization concept.

#### **Overview:**

### **STRATEGY**

1. **Risk Intelligent Enterprise Management Policy** - The CalPERS Board of Administration (the “Board”) adopt a Risk Intelligent Enterprise Management Policy that establishes a common set of risk definitions, defines the roles and responsibilities of the Board and Executive Management, outlines risk management guiding principles, and articulates the value proposition surrounding risk intelligent enterprise management. Please refer to Agenda Item 3a.
2. **The Office of Enterprise Risk Management/Chief Risk Officer** - The Board approve the prompt establishment of the Office of Enterprise Risk Management (OERM) and the position of Chief Risk Officer (CRO), reporting directly to the Chief Executive Officer (CEO)/Deputy Executive Officer, Operations, as the focal point for all enterprise risk management activities. The CRO will have independent authority to determine if risk exposures taken by the organization are in compliance with risk tolerances

and guidelines set forth by the Board. The OERM will strategically integrate the management of risk with existing organization reassurance functions. This approach will result in the creation of a competency center or working team of specialists in risk management, compliance, information security, and business management.

The CRO will direct the activities of the OERM and will have the authority and be primarily accountable for:

- Vetoing proposals or practices that exceed approved risk limits until further review by executive management.
- Escalating issues such as fraud, waste, abuse, and policy violations to the Board and CEO as necessary.
- Developing CalPERS risk intelligence capabilities by interfacing with all business units and central functions.
- Providing independent risk oversight and reassurance
- Coordinating all enterprise risk management and related reassurance activities.
- Providing independent oversight and assessment of significant risk exposures for all CalPERS programs and functions.
- Providing the Board and the CEO with reassurance that management's mitigation strategies are effective through independent review and reports.
- Provide regular risk reports to the Board.

Please refer to Agenda Item 3b.

3. **Executive Management Committee/Enterprise Risk Management Committee** - The CEO convene Executive Management as the Enterprise Risk Management Committee (ERMC) to address risk and value strategy. The consideration of risk, the potential for loss or harm, or the diminished opportunity for value enhancement, is a primary responsibility of Executive Management. Executive Management, in fulfilling its role as the ERMC will provide the appropriate forum for discussion and decisions with regard to these strategies. To define the role and responsibilities of the ERMC, an Enterprise Risk Management Committee Charter (Attachment 1) has been created.

## **PROCESS**

1. **Risk Management Framework** – Adopt a consistent risk management framework to be used to identify, analyze, evaluate, treat, monitor, and communicate risk across CalPERS management. This will move the

organization to a more proactive stance with regard to enterprise risk management.

2. **Risk Assessment of Policy Issues** – Immediately utilize the adopted risk management framework to address risk exposure with regard to current and near-term enterprise policy issues.
3. **Risk Reporting and Monitoring Protocol** – Adopt a coordinated enterprise-wide reporting and monitoring protocol for the consideration of risk in the development of policies and analysis of significant issues and opportunities. Improving communication across the organization will help to break down organizational silos.

### **BEHAVIOR**

An organization's culture is the collection of beliefs, values, and behaviors of the people within the organization. It is not only about what people say is important, but also what people do and the things they hold up as important. Most importantly, it is about the people living out these beliefs and values in a consistent and visible way.

To be effective, Risk Intelligent Enterprise Management must be embedded into the organization's culture, including strategic and business planning decisions, program, policy and contract development, and workload management. It should be included in the organization's policies, procedures, and practices, not a separate business activity. When achieved, the entire organization will have become involved in sustainable enterprise risk management.

The following are fundamental strategies for embedding risk into CalPERS organizational culture:

1. **Reinforcing the Risk Framework**
  - Use the framework in everyday business decision-making versus approaching it as an independent process.
  - Embed risk thinking and awareness into the culture of the business.
  - Learn from our successes and failures and freely share those lessons.
2. **Utilizing Metrics (Internal and External)**
  - Take measures of key risks and publish across organizational units to cost effectively eliminate unwanted variability, improve resilience to adversity and agility to seize opportunity.
  - Incorporate such metrics in executive performance appraisals.

**3. Setting Tone at the Top**

- Set individual objectives for risk management, establishing the successful management of risk as a performance evaluation criterion.
- Senior Management involvement in risk decisions can set the tone.
- Continue to reinforce the value-risk relationship, emphasizing how the management of risk creates opportunities for greater success.
- Report on the work of the Enterprise Risk Management Committee.

**4. Adopting and Utilizing Common Language and Definitions**

- Use common language when communicating about risk (see Attachment 2).
- Incorporate the discussion of risk as a normal part of organizational conversation.

**5. Conducting Training**

- Formal coursework builds skills and sets expectations.
- Use discussion or focus groups to explore others ideas concerning existing and potential risk situations, and mitigation strategies.

**6. Performance Management and Metrics**

- Risk management should become an integral component of performance management and compensation review.
- To ensure this takes place, the CRO should actively participate in performance and compensation reviews of all senior executives.

**V. STRATEGIC PLAN:**

This agenda item supports Goal II of the Strategic Plan, which provides that CalPERS is committed to fostering “a work environment that values quality, respect, diversity, integrity, openness, communication, and accountability.”

**VI. RESULTS/COSTS:**

The results of this Project will be to ensure that CalPERS has in place the appropriate framework to become a risk intelligent organization that improves its decision-making by having an enterprise-wide approach to identifying, understanding, and managing risk. Implementation of these recommendations will result in the integration of risk intelligent enterprise management into CalPERS overall governance, management, reporting processes, policies, philosophy, and culture. The creation of the OERM and the position of CRO will provide a central focal point for all enterprise risk management and reassurance activities. As a risk intelligent organization, CalPERS will be in a better position to take advantage of

Members of the Ad Hoc Risk Management Committee  
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opportunities that will enhance future value and protect existing value for its members and employers.

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Attachments